BP-225E

Backgrounder

EUROPE 1992:
THE EXTERNAL IMPLICATIONS

Anthony Chapman
Economics Division

January 1990

Library of Parliament
Bibliothèque du Parlement

Research Branch

The Research Branch of the Library of Parliament works exclusively for Parliament, conducting research and providing information for Committees and Members of the Senate and the House of Commons. This service is extended without partisan bias in such forms as Reports, Background Papers and Issue Reviews. Research Officers in the Branch are also available for personal consultation in their respective fields of expertise.

Cat. No. YM32-2/22SE

ISBN 0-660-13647-3

CE DOCUMENT EST AUSSI
PUBLIÉ EN FRANÇAIS

TABLE OF CONTENTS

INTRODUCTION 1

ORIGINS OF THE EUROPEAN COMMUNITY 2

THE UNCOMMON MARKET 3

THE 1992 PROGRAM 7

A. Removal of Physical Barriers 7
1. Control of Goods 7
2. Control of Individuals 10
B. Removal of Technical Barriers 12
1. Free Movement of Goods 12
2. Public Procurement 14
3. Free Movement for Labour and Professionals 15
4. Common Market for Services 16
a. Financial Services 16
b. Transport 18
c. New Technologies and Services 18
5. Capital Movements 19
6. Industrial Cooperation 21
7. Application of Community Law 22
C. Removal of Fiscal Barriers 22
D. The Social Dimension of Europe 1992 24
E. Economic and Monetary Union (EMU) 26

THE EXTERNAL IMPLICATIONS OF 1992 27

A. Customs Union Theory 27
B. Reciprocity in the Financial Sector 31
C. Procurement 33
D. Technical Standards 35
E. Rules of Origin, Local Content and Anti-dumping Action 37
F. Broadcasting 39

CONCLUSION 40

SELECTED REFERENCES 43

CANADA

LIBRARY OF PARLIAMENT
BIBLIOTHÈQUE DU PARLEMENT

EUROPE 1992: THE EXTERNAL IMPLICATIONS

INTRODUCTION

The European Community (EC) has embarked on an ambitious program to integrate its internal market and thus create the largest trading bloc in the world with 325 million consumers and a GDP rivalling that of the United States. The plan involves removing the existing physical, technical and fiscal barriers to the free movement of people, goods, services and capital amongst the 12 member countries of the EC. The program set out in the EC Commission's June 1985 White Paper "Completing the Internal Market" is now well underway and over half of the 279 proposals have been approved by the European Council. As a result of this progress and the preparations being made by European business, the European Council and the European Commission have called the process of completing the single market "irreversible."

The EC's trading partners have also begun to regard the completion of the single market with seriousness as well as a measure of concern. Non-member countries fear that as the EC breaks down internal barriers to trade it might erect higher external impediments, to create a kind of "Fortress Europe." With the EC accounting for one fifth of world trade, the consequences of Europe's turning inward would not be trivial for outside countries. Viewed as a single entity, the EC is Canada's second largest trading partner, absorbing $11 billion in Canadian goods exports in 1988, while this country imported $16 billion worth from the EC.

The first section of this paper provides a brief history of the origins of the EC and evidence of its failure to create a true single market. The second section summarizes the 1992 program, which includes not

only the creation of a single market but steps leading to eventual economic and political union. The third section examines the effects of European integration on the outside world, highlighting some of Canada's concerns.

ORIGINS OF THE EUROPEAN COMMUNITY

The European Community originated on 18 April 1951, when six countries, Belgium, France, Italy, Luxembourg, the Netherlands and West Germany, signed the Treaty of Paris founding the European Coal and Steel Community (ECSC). The founding members believed that joining their steel and coal markets would not only be more efficient but that integration of this key war-making industry would also prevent another armed conflict in Europe. The success of the ECSC led to further efforts to integrate European markets and in 1957 the Treaty of Rome was signed by the six members of ECSC, to found the European Economic Community (EEC). Another Treaty of Rome, signed in 1957, established the European Atomic Energy Community (Euratom). Thus, in a legal sense, there are actually three Communities: the ECSC, the EEC and Euratom, but from a political standpoint they can be viewed as a single "European Community."

The reason for the formation of the EEC was to establish a single European market eventually leading to economic and political union. The Treaty of Rome provided for the elimination over 12 years of all internal tariffs, quotas, bounties, differential freight rates, discriminatory taxes and foreign exchange restrictions. By 1968, member countries had harmonized their tariffs against imports from outside countries with the EEC Common Customs Tariff (CCT) and internal tariffs and most quotas had also been eliminated. The rules permitting the movement of labour between countries came into effect immediately upon implementation of the Treaty but in practice there remained a number of barriers to completely free movement of labour, capital, goods and services.

Britain attempted to join the EC first in 1961 and again in 1967, but the application was vetoed each time by French President Charles de Gaulle. With the succession of Georges Pompidou to the French Presidency, Britain's application received a favourable response and

on 1 January 1973, Britain, Ireland and Denmark became members of the EC. Greece was admitted into the EC with a full membership in 1981 while Spain and Portugal were accepted as the eleventh and twelfth members in 1986.

THE UNCOMMON MARKET

Despite success by the EC at removing the more obvious forms of internal protection such as tariffs and most quotas, many non-tariff barriers remained and have multiplied in recent years. The wide array of remaining internal trade barriers includes: border formalities and inspections; technical and safety standards; national preference in purchasing and taxation; national transportation quotas; government aid; and price regulation. In the late 1970s and early 1980s, driven by high domestic unemployment in the EC and increased competition from Japan and the newly industrializing countries, there was an increasing tendency for member countries to resort to such protectionist measures.

One indication of the degree to which non-tariff barriers had fragmented the internal market is the divergence of prices of identical goods sold in member countries. Table 1, compiled by the Union Bank of Switzerland, compares the price of men's clothing, household appliances and general prices in various European cities in mid-1979. Table 2 displays Belgian and British prices for the same Ford automobile models.

A 1978 EC Commission-sponsored study estimated that for a group of 100 selected electrical goods (electrical appliances, stereos and video products) average prices in Denmark exceeded those in Italy by 50%. In Italy and France, countries with more than 20 years membership in the EC and sharing a common boundary, the differential in average prices was 30%.(1)

Economic theory indicates that when a product is sold into more than one market, a firm can maximize profits by tailoring the price

(1) R.C. Hine, The Political Economy of European Trade: An Introduction to the Trade Policies of the EEC, Harvester Press, Brighton, U.K., 1985, p.63.

TABLE 1

European Price Differentials:
Prices in Various Cities, Mid 1979
Zurich = 100

	General Prices	Household Appliances	Men's Clothing
Amsterdam	79	59	100
Brussels	89	93	109
Copenhagen	102	92	133
Dusseldorf	96	69	85
Paris	95	73	85
London	81	62	51
Zurich	100	100	100

Source: Prices and Earnings Around the Globe, Union Bank of Switzerland, 1980.

TABLE 2

FORD AUTOMOBILE PRICE DIFFERENCES

	BRITISH PRICES	BELGIAN PRICES	DIFFERENCE
Escort GL1300	£5,027	£4,267	£760
Escort XR3	£5,750	£5,277	£473
Fiesta Ghia	£5,150	£4,186	£964
Granada L2300	£7,600	£5,798	£1,802

All prices include British car tax. Belgian prices are converted from Deutschmarks at DM 4.22=£1, and include a delivery charge to Belgium of DM1500.

Source: Britain, House of Lords, Select Committee on the European Communities Internal Market: The Movement of Manufactured Goods within the Internal Market of the European Community, 17th Report, 13 July 1982. p.xix.

according to the demand in each market. However, maintaining different prices in each country implies that national markets can be kept separate. Otherwise, entrepreneurs would equalize prices in the various countries by buying in the low-priced national market and selling in the high-priced market. To discourage such "parallel imports," firms typically use techniques such as market sharing arrangements, granting exclusive dealerships for national territories, instituting small design changes for each market and establishing different national brand names. Governments also segment the EC market, however, by measures such as establishing different national technical and safety standards.

Sometimes governments even appear intentionally to prevent the entry of parallel imports of specific products. For instance, in 1981, The Economist magazine showed that a British Leyland Mini Metro automobile built in Britain was priced at the equivalent of £1,591 in West Germany, £2,035 in Italy and £2,666 in Britain.(2) After The Economist reported this price distortion, the British authorities moved to restrict parallel imports by requiring that commercially-imported cars have British type-approval certificates which are available only from British auto-makers or from importers of continental models.

The absence of a single integrated European market is regarded by many as the EC's greatest failure since this was a primary reason for establishing the common market. In 1983, the Commission of the EC released a report entitled "Assessment of the Function of the Internal Market," which noted that delays associated with internal border formalities alone were costing the equivalent of between 5%-10% of the value of the goods traded.(3) The costs imposed by internal trade barriers presented significant obstacles to cross-border sales by large firms, but for many small firms they proved to be insurmountable.

In the early 1980s, members of the EC became concerned about the high rates of unemployment and low rates of economic growth in the

(2) "The Common Scandal of the Uncommon Market," The Economist, 19 September 1981, p.56.

(3) Commission of the European Communities, Assessment of the Function of the Internal Market, 24 February 1983, p.8.

Community compared with its two major competitors, Japan and the United States. Further, there was the perception that Europe was lagging in research and development, innovation and competitiveness. While Japan's share of OECD exports of industrial goods increased by 5.4% between 1979 and 1985, and the U.S. share rose by 0.7%, the EC's portion declined by 1.4% (excluding intra-EC trade).(4) The EC's problems, termed "Eurosclerosis," alarmed member governments sufficiently that at a summit meeting in Copenhagen in 1982 the European Council made completion of the internal market a priority.

In 1985, the Commission of the EC presented to the European Council a White Paper on completing the internal market,(5) which identified a number of impediments to the mobility of goods, services, persons and capital in the European market. The internal barriers were categorized as physical, technical or fiscal in nature and the White Paper proposed a total of 300 directives (later reduced to 279) for their elimination by 31 December 1992. Thus, the year 1992 began to take on particular significance.

Although completion of the internal market was a popular goal with EC members, implementation could have dissolved into endless debate had it not been for passage of certain provisions of the Single European Act (SEA). The SEA amended the Treaty of Rome to permit the Council of Ministers to adopt most directives affecting the functioning and establishment of the internal market by a qualified majority. Member states had previously had effective veto power over all proposals from the bureaucracy (the European Commission) that were introduced in the EC Council of Ministers; a "qualified majority," however, requires only 54 Council votes out of a total of 76. (The number of votes it is apportioned in the Council reflects each state's population and economic strength but no country has more than ten.) Exceptions to the qualified voting rule include measures relating to fiscal actions, free movement of persons and

---

(4) United States, U.S. International Trade Commission, Effects of Greater Economic Integration within the European Community on the United States, Washington, D.C., July 1989, p.16.

(5) Commission of the European Communities, Completing the Internal Market, White Paper to the European Council, Brussels, June 1985.

the rights and interests of employed persons. Nevertheless, the new rules represent a significant streamlining of the EC's decision-making process with about two thirds of the White Paper's proposals subject to qualified majority voting.

The SEA also establishes the principle of mutual recognition, which is of particular significance for the completion of the internal market. This states that "the Council may decide that provisions in force in a member state must be recognized as being equivalent to those applied by another." As will be shown later, the principle is having a major impact in breaking down technical barriers to trade in the EC.

In early 1986, the Commission authorized a major research project on the cost of fragmentation in the internal market and by implication the potential benefits of completing the internal market. The study, commonly referred to as the Cecchini Report, concluded that removing internal trade barriers would add approximately 4.5% to the Community's gross domestic product, lower consumer consumer prices by about 6.1% and increase employment by about 1.8 million persons.(6)

THE 1992 PROGRAM

A. Removal of Physical Barriers

1. Control of Goods

As the White Paper pointed out, to the ordinary citizen there is no clearer illustration of the continued division of the Community than the physical barriers faced at customs posts. For individuals, border delays can be annoying and time consuming but for industry the delays, formalities and transport and handling charges impose an unnecessary and costly burden.

Before the introduction of the Single Administrative Document in 1988, it is estimated that a trucker travelling through the EC would spend one-third of his time stopped at borders and completing up

(6) Michael Emerson et al., The Economics of 1992, Oxford University Press, Oxford, 1988, p.216.

to 200 forms. The impact of border delays on truck travel time is illustrated in the Cecchini Report by a comparison between two 1200 km truck journeys. One trip, entirely within Britain, took 36 hours; another trip, from London to Milan, took 58 hours (excluding time lost crossing the channel) suggesting that border delays cost over 50% of truck travel time.(7)

The Cecchini Report estimated that for six countries (Belgium, France, Germany, Italy, the Netherlands and the United Kingdom) firms pay about ECU 8 billion (or almost 2% of transborder sales) in administrative costs and delays caused by intra-EC customs procedures. Businesses were estimated to forego an additional ECU 4.5 billion to ECU 15 billion in sales (or 1%-3% in intra-EC trade) as a result of border formalities while government spent a further ECU 500 million to ECU 1 billion on staffing and administering border checks.(8)

Studies indicate that smaller firms are particularly affected since they lack sufficient volume of business over which to spread the fixed costs associated with border formalities. According to surveys carried out for the Cecchini Report, elimination of border restrictions would increase exports by small firms (less than 50 employees) by an average of 26% and raise imports by 22%. Large firms (more than 500 employees) could be expected to increase exports by 10% and raise imports by 8%.(9)

The White Paper made it clear that the Commission does not intend merely to simplify border controls but to abolish them entirely. The Commission realized that accomplishing this goal would require either eliminating the underlying reason for the controls or finding alternatives to them that would achieve the same end.

For example, a primary reason for maintaining internal customs procedures is to ensure that value-added taxes (VAT) and excise duties are remitted on exports and applied to imports. Thus, eliminating physical barriers depends on the removal of fiscal impediments. The plan to

---

(7) Paolo Cecchini _et al._, _The European Challenge, The Benefits of a Single Market_, Gower, Aldershot, U.K., 1988, p.12.

(8) _Ibid._, p.89.

(9) _Ibid._, p.14.

harmonize VAT and excise duties was outlined in a separate section of the White Paper.

Article 115 of EEC Treaty permits the EC Commission to authorize member states to block the entry of protected products. This has led to the introduction of individual national import quotas and prohibitions requiring intra-Community border controls for their enforcement. Adoption of a truly common EC commercial policy would eliminate individual state quotas against textiles and clothing under the Multifibre Arrangement or individual "Voluntary Restraint Agreements" limiting the entry of Japanese automobiles. Other examples include restrictions against New Zealand lamb, which is imported into Britain but must be prevented from entering other EC markets, and restrictions keeping cheaper bananas from the continent out of Britain. The White Paper proposed abolishing by 1992 all regional and national quotas and replacing these with Community-wide import restrictions. If elimination of all individual quotas proved impossible, alternatives to border controls would need to be found. In the steel trade, free market competition is proposed in order to obviate the need for frontier checks of steel shipments.

The White Paper recommended automatic adjustment of agricultural prices under the Common Agricultural Policy (CAP) to reflect exchange rate movements and remove the need for frontier checks and monetary compensation applied to trade between EC members. Commodities subject to countervailing charges will have to be brought under a common organization.

The Community has also begun a program to harmonize essential health requirements and the White Paper proposed the establishment of more common standards. It also suggested that plant and animal checks be made at the point of departure while certificates be checked at the place of destination. Plants and animals from non-EC countries that comply with Community standards will be permitted free circulation throughout the EC.

With respect to frontier controls affecting transportation, the Commission recommended the abolition of bilateral permits rationing the

number of cross-border truck trips by vehicles of each country and the adoption of common safety standards for vehicles.

Prior to the White Paper, several important steps had already been taken toward simplifying EC customs procedures. The Single Administrative Document (SAD) facilitates the import, export and transit of goods over EC borders by consolidating a multiplicity of other trading forms into a single document. Other steps to ease the customs burden include the introduction of the harmonized system of customs classification and the application of a new Community tariff (TARIC) to goods whose classification have been harmonized. All three measures came into effect on 1 January 1988.

The 1992 program continues the simplification of customs procedures. Among the regulations introduced are those standardizing forms for imports and exports outside the Community, applying the SAD to shipments made under other EC treaties such as the European Coal and Steel Community treaty, and eliminating checks of goods in transit to third countries.

At 31 May 1989, the Council of the EC had adopted 36 White Paper proposals related to physical barriers. A further 23 proposals had been submitted to the Council by the EC Commission but had not yet been adopted. The final 30 Commission proposals to remove physical barriers had not been presented to the Council.(10)

2. Control of Individuals

There are two main reasons why individuals remain subject to checks at internal EC borders: taxation and immigration/security. The first reason, to determine whether any tax is owed on goods accompanying travellers, relates to national differences in rates of VAT and excise taxation. The current tax-free allowance of 350 ECU reduces, but does not eliminate, the need to check for evasion of indirect taxes. The plan to

---

(10) Commission of the European Communities, Fourth Progress Report to the Council and the European Parliament Concerning the Implementation of the Commission's White Paper on the Completion of the Internal Market, Brussels, 20 June 1989.

remove the ceiling on tax-free allowances by the end of 1992 will likely depend on achieving a measure of harmonization of indirect taxation (see later section on fiscal barriers). Directives have also been passed providing for tax-free entry of non-commercial consignments and for private transportation vehicles imported temporarily.

The other reason for checking individuals travelling within the Community is connected to national differences in laws governing immigration, terrorism, drugs and firearms. The White Paper proposed the approximation of drug and arms legislation in order to remove the need for checks at internal borders for these purposes. It also called for Community policies on visas permitting the free movement of third country nationals within the Community, on the right of asylum and the status of refugees, and on extradition. The White Paper noted that controls at external barriers would have to be strengthened and cooperation enhanced between police and other relevant agencies in member states.

There has been some progress toward removing border controls facing individuals. The Community has begun issuing new Euro-passports with the individual's country recorded beneath the EC identification. For automobiles, member states will issue green discs showing the letter "E" for display on car windshields to signify that those passengers are EC nationals and should be accorded the right of free passage. Cars showing this emblem would need only to reduce speed at borders, to permit authorities to make a visual check. Individual Community nationals would merely present their closed EC passports to border officials and pass through internal borders unchecked. However, security checks at airports would remain and authorities could carry out spot checks at the border or within a 15 km frontier zone, providing these were kept to a minimum.

Despite this progress, major hurdles remain to making the Community truly frontier-free. The original six EC countries of Belgium, the Netherlands, Luxembourg, Germany, France and Italy, have indicated their intention to eliminate border controls entirely. As an island, however, Britain prefers to check people at its borders rather than monitoring them from within as is the French practice. Under the Nordic Union, Denmark permits citizens of Scandinavian countries to enter without

border checks and this complicates Denmark's border control arrangements with other EC states. With respect to harmonization of firearms regulation, a wide disparity exists between controls in France and West Germany. Finally, at this stage it seems improbable that member states will agree to trust completely each other's external border controls against drugs and terrorism.

B. Removal of Technical Barriers

1. Free Movement of Goods

Although less visible, differences in technical regulations and standards can limit trade in goods as effectively as do the physical barriers at border posts. These differences may involve anything from the ingredients permitted in beer or pasta to the safety features mandated for electrical appliances. Different technical specifications in the EC, which were estimated in 1983 to number about 100,000, segment the internal market of the EC into smaller national markets.(11) Meeting the numerous specifications of the individual national markets requires companies to produce in smaller batches. This limits the production volume over which to spread fixed costs for plant and equipment and research and development. Thus, plants are often of sub-optimal size in the EC resulting in higher prices for EC consumers and products that are less competitive in outside markets.

As the Cecchini Report points out, technical barriers are sector specific so that it is impossible to assess the overall costs they impose on the EC economy. Some idea of how these barriers affect economic efficiency can, however, be gleaned by examining evidence from several industries. In the telecom sector alone, the costs of national technical regulations and standards combined with restrictive procurement practices were estimated to cost the EC economy as much as ECU 4.8 billion. Over ECU 800 million in costs imposed on four foodstuffs (chocolates, beer, ice-cream and pasta) was attributed to content and ingredient regulations.

---

(11) Cecchini (1988), p.28.

In the automobile sector, at least ECU 286 million for development costs of a passenger car was imputed to differing national specifications.(12)

Until recently, the EC method for dealing with the proliferation of technical standards was to draw up Community-wide standards and require national standards to conform to these. However, this procedure, involving the design and agreement on a set of technical standards, often on a product by product basis, proved too time-consuming to accommodate the annual introduction of some 5,000 technical standards.

The EC Commission is attacking the plethora of European technical standards and specifications under two guiding principles: mutual recognition and harmonization. The principle of mutual recognition states that where human health and safety are not at stake, goods legally manufactured and marketed in one member country must be permitted free entry into other member states. This principle was given legal force by the landmark Cassis de Dijon case in 1979, where the European Court of Justice ruled that West Germany could not block the importation of the French liqueur, Cassis de Dijon, simply because it did not contain enough alcohol to qualify as a liqueur under West German standards. Since West Germany could not show that the liqueur was excluded for reasons of health, fiscal supervision, fair trading or consumer protection, it was forced to admit the beverage. This ruling has been instrumental in striking down other discriminatory technical standards such as the Bavarian beer purity law in Germany and Italian regulations requiring pasta be made exclusively from durum wheat rather than softer varieties.

Harmonization is to be the guiding principle in cases where different national standards can be justified on the basis of health or safety. The White Paper proposed that the EC legislate only the essential requirements and leave to standards-setting bodies the job of designing the technical specifications. The three European standardization bodies are: CEN (Comité européen de la normalisation), CENELEC (Comité européen de la normalisation électrotechnique) et ETSI (European Telcommunications Standards Institute). The standards are being hammered out in an interactive process involving CEN, CENELEC and ETSI technical committees,

(12) Ibid., p.26.

European technical experts, producers, users and national standards organizations acting for state policymakers.

Pending the introduction of specific standards, products that meet the broad legislated requirements will be permitted free movement within the Community. Once the standards have been set, products that conform to the specifications will be presumed acceptable while manufacturers of products not made according to the standards will be obliged to prove that their goods meet the original harmonization directive.

The Commission's new approach will also stress "horizontal" harmonization (defining broad features across categories of goods) rather than the lengthy development of "vertical" standards on a product by product basis. In order to bar the formation of new technical barriers, member states will be required to notify the Commission before introducing new technical specifications and allow the Commission time to consider their admissibility.

At 31 May 1989, of the 79 proposals connected to the removal of technical barriers, 54 had been adopted by the EC Council, 21 had been submitted to the Council but still required adoption and 4 had yet to be presented by the Commission to the Council.(13)

2. Public Procurement

The Cecchini Report estimated that public purchasing in the EC was worth ECU 530 billion in 1986 or 15% of the Community's GDP. While a large share of these sales were of a size or nature that could not easily be supplied by firms located outside the country of purchase, an estimated ECU 240 billion-ECU 340 billion of sales (7%-10% of GDP) were made on a contractual basis; however, only about 0.14% of contracts were awarded to firms located outside the country of purchase. It is estimated that opening public procurement to foreign suppliers would provide a saving of ECU 17.5 billion (0.5% of Community GDP).(14)

---

(13) Commission of the European Communities, Fourth Report (1989).

(14) Cecchini (1988), p.16.

The EC Commission proposes to open national public procurement to foreign suppliers by: closing loopholes in existing EC rules respecting government procurement; providing firms with the right to take legal action with respect to how government contracts are awarded; enhancing EC supervision of member state procurement practices; and opening up to outside bidding sectors of procurement that are currently excluded. These excluded sectors, which include energy, transport, telecommunications, and water supply, make up 25% of government purchases. Eventually, it is intended to include the services sector under EC procurement rules.

In its fourth progress report on the completion of the internal market, the Commission stated that the Council had adopted one directive closing loopholes in existing procurement legislation and it had been incorporated in most member states' legislation.(15) Four other proposals had been submitted to the Council and awaited adoption, including those opening up the four excluded sectors. The proposal for public procurement in the field of services had not yet been submitted to the Council.

3. Free Movement for Labour and Professionals

The White Paper noted that while there had been substantial progress in facilitating the free movement of employees, there had been little with respect to the right of establishment for the self-employed. The negotiations required to agree on the qualifications and training requirements to practise a profession can take years to complete; for example, it took 17 years and 16 years respectively to arrive at Community directives permitting architects and pharmacists to practise anywhere in the EC.

As a result of the slow progress in this respect, the Community will apply the principle of mutual recognition to degrees and diplomas issued in different member states. The only additional requirement may be a period of supervised work experience in the country of residence.

---

(15) Commission of the European Communities, Fourth Report (1989).

Eventually, persons who qualify in a profession in one country will be permitted to practise anywhere in the EC.

At 31 May 1989, the Commission reported that seven proposals related to free movement for labour and the professions had been adopted by the Council. These included a proposal to establish the comparability of vocational training qualifications and one for mutual recognition of higher education diplomas awarded on completion of professional education and training of at least three years. Two White Paper proposals submitted to the Council awaited adoption and five proposals were still to be presented to the Council.(16)

4. Common Market for Services

a. Financial Services

It is estimated that integration of the European financial services market would provide gains of ECU 22 billion to the eight countries of Belgium, Germany, Spain, France, Italy, Luxembourg, Netherlands, and the U.K.(17) This research showed that differences of 50% or more commonly exist between the cost of financial instruments offered in various markets.

Liberalization of financial markets under the 1992 program is being built upon four principles. The first principle, free movement of capital across borders, is covered in a subsequent section of this paper. The second principle, harmonization, requires member states to harmonize standards of capital adequacy and accounting requirements for financial institutions. The third principle, mutual recognition, means that member states must trust each others' interpretation of the essential standards laid out by the Council. The fourth principle, home country control, signifies that supervision of the sale of financial products primarily will be the responsibility of authorities in a financial institution's home country.

Under the EC's Second Banking Directive, a credit institution authorized to engage in specified commercial and investment

---

(16) Ibid.

(17) Cecchini (1988), p.37.

banking activities in its home country would be issued a single banking licence permitting it to sell the same financial services in other member states. Banking services could be sold across borders or by establishing branches in other member countries with primary responsibility for their supervision residing with authorities in the institution's home country. Host country control would apply, however, in the case of non-member country branches of institutions not incorporated in the EC and for activities not specifically authorized in the harmonization directive. Supervision by the host country would also continue to apply with respect to liquidity of credit institutions, measures affecting monetary policy and reserve requirements of operations of credit institutions in securities markets.

To illustrate, suppose a branch of Lloyds Bank located in England made a commercial loan to a borrower in France. Such a sale across borders would be subject to British regulatory control. British regulation would also apply if Lloyds Bank chose instead to provide the loan through a Lloyds Bank branch located in France. However, French regulation would apply in the case of a loan by a subsidiary of Lloyds Bank incorporated in France.

Like the banking directive, the Investment Services Directive incorporates home market control based on mutual recognition of other countries' financial standards. This, in turn, depends on achieving a degree of harmonization of standards between member countries. Investment services such as portfolio management, stockbroking, securities dealing or market making, options and futures trading as well as the sale of investment advice could be provided across borders or by establishing branches in other member countries.

With respect to the sale of insurance services, the EC directives differentiate between individuals or small policy holders who require protection and large commercial customers who can fend for themselves. Cross-border sales of insurance to individuals would be subject to home country control only where the person took the initiative to purchase the policy in another member state. On the other hand, policies sold across borders to individuals through insurance company soliciting

would remain subject to host country rules. It is expected that by the middle of 1990 insurance companies will be free to offer large commercial policies anywhere in the Community.

In the fourth report, the Commission recorded 10 proposals respecting financial services adopted by Council. A further 12, including the Second Banking Directive, awaited the Council's approval.(18)

b. Transport

With more than 7% of GDP in the EC provided by transportation services, there are significant potential gains to be realized through the deregulation of the sector. Inefficiencies permeate this sector so that trucks are often forced to return home empty because of national permit quotas and restrictions on internal transportation within countries. The Commission has proposed injecting some measure of competition to all modes of transport, including road, rail, inland waterways, marine transport and air.

In the road freight transport sector, the Commission proposes to replace the current system of bilateral quotas with EC-wide authorizations. In maritime transport, carriage by sea and inland waterways would be open to carriers from any member state. Air Transport would be opened to limited competition with less interference by governments in setting fare prices, allowing access to routes by multiple carriers and liberalizing rules on capacity sharing of passengers.

In the fourth progress report on the completion of the internal market, five transport proposals are recorded as adopted by the Council, five proposals submitted to the Council awaited adoption and three proposals had yet to be submitted.(19)

c. New Technologies and Services

Research and development on new technologies required for audio-visual communication and information and data processing services can be extremely expensive. Consequently, the market for these services must

(18) Commission of the European Communities, Fourth Report (1989).
(19) Ibid.

be sufficiently large to offset these expenditures. Unfortunately, different national standards and the monopoly power of state-owned telecommunications networks serve to segment the EC into a number of smaller national markets. The Commission has proposed that basic telecom networks (especially for telephones) remain under the administration of the national monopolies but that the so-called value-added services (fax, vision and data transmission) be open to competition.

The Commission has also proposed that legal and technical barriers to the free circulation of audio-visual broadcasts be removed, thus creating a single European market for radio and television services. Broadcasters would be encouraged to reserve a major share of television programming time for EC productions. Other standards governing radio and television broadcasts relate to the amount and type of advertising permitted, a prohibition on broadcasts deemed harmful to children, arbitration in disputes over remuneration for copyright holders in retransmission of broadcasts by cable, and the right of reply for persons whose reputation has been damaged by the broadcast of incorrect information. The EC is also committed to the development of a European standard for high definition television.

The Commission's fourth report on the completion of the internal market stated that two proposals had been passed; one deals with the establishment of a pan-European system for mobile telephones and the second with the creation of a common information market. Proposals submitted to the Council and awaiting approval included those affecting broadcasting and the establishment of the internal market for telecommunications services. The proposed directive on the approximation of laws concerning telecommunications terminal equipment had yet to be submitted to the Council.(20)

5. Capital Movements

Removal of internal restrictions on the free flow of capital is central to the achievement of a single efficient financial services market; the integration of securities markets and the provision of

---

(20) Ibid.

financial services across borders depends on this. The U.K., Germany, the Netherlands, and Denmark do not currently impose restrictions on capital flows with EC members or with outside countries; however, Belgium and Luxembourg operate a dual exchange rate system maintaining an official rate for trade and direct investment while permitting other transactions to be concluded at the market rate, France restricts its nationals from establishing foreign deposit accounts, and Italy imposes a number of restrictions on its residents, including a requirement to surrender foreign exchange holdings.

In June 1988, the Council adopted a directive requiring EC members to remove, by 1 July 1990, all remaining controls on capital movements. There are exceptions for Spain and Ireland, which do not need to comply with the directive until the end of 1992, and for Greece and Portugal, which have until 1995. Belgium and Luxembourg must abolish their two two-tier exchange rate system by the end of 1992. The new rules mean that banks will be able to lend to non-residents and EC citizens will be able to hold bank accounts in other member states.

France has registered its concern that the removal of restrictions on short term capital movements will lead to widespread tax evasion as residents move their savings to other, less heavily taxed, countries. While the EC Commission has suggested a withholding tax of 15% on interest income as a solution, there is little support for the measure. In early 1989, West Germany imposed its own withholding tax of 10%, which promptly gave rise to a flight of capital to Luxembourg; the measure was quickly withdrawn. Even if all EC countries were to harmonize to a common withholding tax, capital would simply flow to alternative countries; Switzerland is one likely destination. Furthermore, Britain is unwilling to impose a withholding tax on large deposits since this would undermine its position as a major financial centre. Thus, many believe that the idea of an EC withholding tax is effectively dead.

There is provision for some derogation from the freedom of capital rules. Member states will be permitted to take measures affecting short term capital movements for reasons of domestic monetary regulation,

to control exceptional exchange rate movements or to prevent infringement of national laws.

6. Industrial Cooperation

The EC has adopted a regulation establishing a legal framework for a new type of corporate association, called the "European Economic Interest Grouping" (EEIG), to encourage cross-border cooperation between firms. Similar in some respects to both joint ventures and partnerships, the new legal relationship will be recognized throughout the EC. The EEIG is less ambitious than a European company statute based on European law but it should help small firms realize some of the economy of scale gains arising from the 1992 program.

The Fifth Company Law Directive would permit a member state to dictate the structure of all companies operating in its jurisdiction. The Directive contains extensive rules including a requirement that managers report to a company supervisory board. A controversial aspect of the proposal is the provision for worker participation in management of companies employing more than 1,000 workers. Germany, which already has a form of worker participation, would like to extend worker rights to other countries in the EC, while Britain remains firmly opposed, since it believes this would enhance the power of the unions.

The Tenth Company Law Directive would establish rules on mergers across borders, which are currently prohibited in most member states. This would enhance significantly the ability of companies to take advantage of the size of the new single market opened up by the 1992 program. The delay in implementing this directive is related to a fear that without prior passage of the Fifth Directive providing EC-wide worker rights, companies would merge into jurisdictions with the most lax rules.

The Eleventh Company Law Directive relieves company branches established in other EC countries from the obligation of disclosing their branch accounts if the annual accounts and annual report of the parent company are published.

The White Paper stated that differences in intellectual property laws reduce intra-Community trade and do not permit firms to treat

the EC as a single market. A directive has been adopted requiring member states to pass laws protecting "mask works" or topography of semiconductor chips from unauthorized reproduction or commercial exploitation. The directive on trademarks would approximate the laws of member states so that the conditions on which trademarks are obtained and maintained and the degree of protection provided would be identical throughout the EC. The Commission's Green Paper on Copyright is expected to lead to the introduction of protection for technological intellectual property such as audio and video recordings, computer programs and data bases. Another proposed directive would provide partial harmonization by member states of patent protection for biotechnological inventions.

Three proposals have been made to remove the tax obstacles to cooperation between enterprises. The first contains an arbitration procedure to eliminate double taxation arising between tax authorities over the issue of transfer pricing. The second involves a common system of taxation applicable to parent companies and their subsidiaries. The third proposal would provide a uniform system for taxation of mergers, divisions and contributions of assets.

7. Application of Community Law

The White Paper proposed to streamline EC internal procedures for dealing with complaints about infringements of EC law. The Commission will also consider the introduction of sanctions against violators or measures to suspend enforcement of national legislation which trangresses EC law. Transparency will be increased through the publication of the legal obligations of member states in various sectors. With respect to state aids (ie. subsidies), the Commission proposes to draw up an inventory of these with a view to injecting some discipline into their provision by member states.

C. Removal of Fiscal Barriers

A primary reason for the continuation of border controls within the EC is the need to enforce the different rates of VAT and excise tax throughout the Community. International practice is to remit indirect

taxes (sales and excise taxes) on exports at the source and to apply these taxes on imports at the country of destination. In this way, exports enter international commerce free of indirect taxation and frontier controls ensure that the tax accrues to the country where the goods are actually consumed and prevent circumvention of payment and fraud.

The Commission's proposal to eliminate border controls related to fiscal barriers has several components. First, VAT would no longer be remitted on exports and applied to imports. Rather, sales across borders would be treated similarly to internal sales; that is, they would be taxable in the hands of the vendor (the exporter) while the buyer (the importer) would be eligible for an input tax credit. Under this system, countries that import more than they export would draw on an international central account set up to clear imbalances between credits and debits while net exporting countries would pay into the system.

Second, the proposal would require the approximation of indirect tax rates among member states. Otherwise, there would be an incentive for traders and individuals to purchase goods in neighbouring low-tax rate countries. The White Paper noted that sales tax rates in neighbouring U.S. states differ by up to 5% without significant distortion of trade patterns. By contrast, VAT rates vary widely in the EC with the standard rate pegged at 12% in Luxembourg and Spain but 22% in Denmark. Furthermore, some countries such as Belgium, France, Greece, Italy, Portugal and Spain impose a special higher rate of 25% to 38% on some items.(21)

Initially, the Commission proposed two bands of VAT rates, a lower band of 4% to 9% for necessities and a higher band of 14% to 20% for other goods.(22) However, this proposal ran into trouble since some countries apply very low rates of tax to sensitive items; the U.K., for example, resisted charging its zero rate of tax for food and children's clothes and shoes. As a result of pressure from member states, the Commission has proposed a VAT band of 0% to 9% for sensitive goods and a

---

(21) "A Survey of Europe's Internal Market," The Economist, 9 July 1988, p.11.

(22) Ibid., p.19.

floor of 15% for other items.(23) The new proposal would impose less stringent harmonization standards on governments and instead let the market forces of competition move VAT rates together.

The rates of excise duty applied by EC member states to alcohol, tobacco and fuels also differ significantly. For example, the excise tax on pure alcohol varied from 48 ECU per 100 litres in Greece to 3,499 per 100 litres in Denmark.(24) For cigarettes, the excise tax rate varies from 0.6 ECU per thousand in Greece to 77.5 ECU per thousand in Denmark.(25)

In contrast to the Commission's VAT proposal, which permitted member states to harmonize tax rates within bands, it was recommended initially that member states harmonize their excise taxes to uniform rates for specific products. The reason for keeping excise tax rates uniform stems from the fact that VAT rates are applied on the price of goods inclusive of excise tax and VAT rates would already vary sufficiently among member states. Subsequently, these proposals were changed due to resistance from member states in favour of different minimum rates for alcohol and tobacco products and single rates or rate bands for mineral oil. To combat tax dodging, member states may use excise stamps or seals while a system of inter-connected excise warehouses will be available to permit the duty-free circulation of excise goods within the EC.

D. The Social Dimension of Europe 1992

With the possible exception of the proposal for a European monetary union, no part of the 1992 program has generated so much controversy within the Community as the assortment of social policy initiatives lumped under the "social dimension" heading. The Community social charter states a number of fundamental rights to which citizens of

(23) Ibid., p.19.

(24) Effects of Greater Economic Integration within the European Community on the United States (1989), p.10-11.

(25) Ibid.

the EC should be entitled.[26] These include the right:

- to freedom of movement throughout the EC for citizens and workers;
- to employment and fair remuneration;
- to improvement of living and working conditions;
- to adequate social insurance protection;
- to freedom of association and collective bargaining;
- to vocational training;
- to equal treatment of men and women;
- to information, consultation and participation of workers;
- to health and safety in the workplace;
- to the protection of children and adolescents afforded by a minimum employment age;
- to a retirement income which affords a reasonable standard of living for the elderly;
- to work if disabled.

The most controversial provision relates to the participation of workers in management decisions, an idea that has been incorporated in the Fifth Company Law Directive outlined earlier. Prime Minister Thatcher of Britain insists that the continent's "socialist" model not be thrust upon Britain and that the EC's legislation of social policy represents an incursion on national sovereignty. Mrs. Thatcher believes that the social charter is not necessary to the completion of the single market and she is suspicious of further concentration of power in the hands of the European government. In a speech in Bruges in September 1988 she stated, "We have not rolled back the frontiers of the state in Britain only to see them reimposed at the European level."[27]

On the other side of the issue, Jacques Delors, President of the EC Commission, stated in a speech to the European Parliament in January 1989, "It will not be enough to create a large frontier-free market, nor, as implied by the Single European Act, a vast economic and social area. It is for us, in advance of 1993, to put some flesh on the Community's bones

---

(26) Commission of the European Communities, Community Charter of Fundamental Social Rights, Preliminary Draft, Brussels, 30 May 1989.

(27) "A Survey of Europe's Internal Market," The Economist, 8 July 1989, p.41.

and give it a little more soul."(28) Mr. Delors is supported in his drive to add a social dimension to 1992 by countries such as West Germany that provide relatively generous social benefits. These countries are afraid that in the absence of minimum standards a kind of "social dumping" will take place where companies flee to locations with the lowest wages and tax rates and the poorest worker protection laws.

E. Economic and Monetary Union (EMU)

Not only does the Single European Act of 1985 enable the EC to clear away internal barriers to trade, it commits member states to "the progressive realization of economic and monetary union." To this end, in June 1988, the EC Council of Ministers set up the Delors Committee of 17 central bankers and experts to study the question. The Report of the Delors Committee, released in April 1989, set out a three stage plan to achieve the goal of monetary and economic union.

In stage one, monetary and economic policies would be more tightly coordinated and the currencies of Britain, Portugal and Greece would join the present European Monetary System (EMS) in which the exchange rates of national currencies are allowed to fluctuate within plus or minus 2.25% of the central rate.

The second stage would narrow the fluctuation band of the national currencies and a European System of Central Banks (ESCB) similar to the U.S. Federal Reserve System would be established and begin determining monetary policy throughout the EC. Macroeconomic policies would be coordinated by the Council of Ministers, which would set guidelines for individual countries.

In the third stage, the Delors Report envisages fixing exchange rates permanently and replacing national monetary units with a common currency. In addition to a common monetary policy, the EC would make binding rules regarding budgetary matters.

While France has ardently embraced the prospects for economic and monetary union and other member states support the Delors Report with varying degrees of enthusiasm, Britain remains outside the

---

(28) Ibid., p.38.

fold. Prime Minister Thatcher has stated that establishment of a European central bank would require surrendering "fundamental economic decisions to another country." "That I will not do," she declared.(29) Despite Mrs. Thatcher's objections, the other EC leaders are determined to go ahead with the proposals and have agreed to meet in January 1991 for an intergovernmental conference to introduce the economic and monetary union.

THE EXTERNAL IMPLICATIONS OF 1992

A. Customs Union Theory

Despite some doubts abroad, the EC literature implies that the 1992 program will benefit both member and non-member countries. It is estimated by the EC that completion of the internal market will add about 4.5% to the Community's GDP with internal trade rising by about 10%, exports to the rest of the world increasing by around 10%, and imports rising by somewhat less to create a trade surplus for the EC of 1% of GDP.(30) The communiqué released at the July 1989 G7 summit in Paris stated, "It is the intention of the European Community that the trade aspects of the single market program should also be trade-creating and complementary to the multilateral liberalization process."(31)

Trading associations between countries can take a number of different forms. Classifying these according to the degree of economic integration, the first stage would be a "free trade agreement," in which tariff and non-tariff barriers to trade were eliminated between signatory countries, with each maintaining its respective trade barriers to non-member nations. A stronger form of economic integration would be a "customs union," which would involve not only dropping trade barriers

---

(29) "Britain, Not Exactly a Joiner, Still Favors a few Barriers," New York Times, 23 October 1988.

(30) Willy de Clerq, "1992: The Impact on the Outside World," Speech, 29 August 1988.

(31) "Key Sections of the Paris Communique by the Group of Seven," New York Times, 17 July 1989, p.A7.

between member countries but applying identical tariffs against outside countries. Still further economic integration would be achieved by also allowing free movement of labour and capital within the trading bloc to form a "common market." A final stage would be "economic union," where national social, taxation and fiscal policies would be unified and administered by a supranational institution. The removal of the European Community's remaining internal barriers under the 1992 program would clearly qualify the EC as a common market while its intention to pursue an economic and monetary union and a social dimension indicates a movement toward the economic union stage. For purposes of examining the EC's external trading relationship, however, the idea of a customs union captures the key elements; removal of internal barriers and establishment of a common external barrier.

Economic theory identifies three types of effect released by the formation of a customs union: first, a once and for all (static) effect involving reallocation of production and consumption choices; second, dynamic gains due to factors such as economies of scale, heightened competition and enhanced technological progress; and third, income effects. Looking for the moment only at the static effects, the formation of a customs union will be beneficial to the world economy if trade creation outweighs trade diversion.

As noted earlier, the formation of a customs union involves both removing trade barriers between member countries and harmonizing external tariffs facing outside countries. The removal of internal trade barriers causes "trade creation" when members shift their purchases from higher cost production located either inside the home country or outside the customs union to more efficient sources within the customs union. "Trade diversion" takes place when the removal of internal trade barriers makes less efficient (but non-dutiable) production inside the union more attractive than efficient (but dutiable) production outside the union.

The formation of a customs union also requires the harmonization of external tariffs. Members of the union that previously had low tariffs would have to raise these against goods from outside countries while others with high tariffs would have to lower them. Where member

countries' external tariffs are "harmonized down," more efficient production outside the customs union may become more attractive than less efficient production inside the union thus giving rise to "external trade creation." Under static analysis, if total trade creation (both inside and outside the union) exceeds trade diversion, the formation of a customs union is said to increase global economic welfare. Most studies on the static effects of the European Economic Community support the case for a customs union, showing trade diversion outweighed some five to ten times by trade creation.(32)

Although global welfare may have been increased from the formation of the EEC, the evidence also suggests that the impact on outside countries was mixed. Some suffered trade diversion while others experienced trade creation. The U.S., for example, may actually have increased its trade with the EEC as a result of the latter's formation.(33) In part, this was due to the reduction of French and Italian tariffs, which were "harmonized down" to the EC's Common Customs Tariff rate, thus giving rise to external trade creation. The same study also indicated that Canada increased its share of the EEC's outside imports of foods and raw materials, although the data covered a period prior to the entry of Britain, an event which caused significant trade diversion of Canadian agricultural exports.

Removing internal physical, technical and fiscal barriers under the Europe 1992 program can be compared in effect to abolishing internal tariffs. At the EEC's formation, removal of internal tariffs generated trade diversion for outside countries. For some countries such as the U.S., this may have been offset by external trade creation when outside tariffs were harmonized. However, external trade creation should not be a factor under the 1992 program since external trade barriers need not be changed this time around. This implies that the primary static effect of Europe 1992 on outside countries will be trade diversion.

---

(32) Hine (1985), p.52.

(33) Bela Balassa, "Trade Creation and Trade Diversion in the European Common Market: An Appraisal of the Evidence," in European Economic Integration, North Holland, Amsterdam, 1975.

Dynamic effects, the second consequence of the formation of a customs union, are benefits that are assumed to flow from gaining access to larger markets. They include: exploitation of economies of scale; increased competition; and technological progress due to additional research and development. The removal of internal barriers under the 1992 program is also expected to give rise to such dynamic effects. As production within the EC becomes more efficient, some goods from outside countries will become relatively less attractive and the demand for these will fall. Thus, the immediate dynamic effects of Europe 1992 are likely to be negative for external EC Trade.

The third consequence for outside countries of integrating the EC internal market is the income effect. While both the static effects and dynamic effects initially are likely to lead to a reduction of trade with outside countries, they are also likely to increase incomes within the EC. This, in turn, implies a greater demand within the EC for goods and services both from domestic as well as from external sources. According to studies done for the European Commission, the reduction in internal trade barriers under the 1992 program will increase EC output by between 2.2% and 2.7% while the dynamic effects attributed to economies of scale from restructuring and competition effects will raise European output by at least an extra 2.1% but perhaps as much as 3.7%.(34)

In summary, the overall impact of Europe 1992 on external trade is ambiguous. The static and dynamic effects would initially have negative consequences for trade with outside countries but would have a secondary positive effect on imports by raising EC income. Whether, the net effect is positive or negative for outside countries is an empirical question but there is no reason to assume that Europe 1992 must result in decreased trade with non-member countries. Of course, implicit in this conclusion is the assumption that Europe 1992 will not lead to higher external trade barriers.

---

(34) Effects of Greater Economic Integration within the European Community on the United States (1989), p.2-8.

B. Reciprocity in the Financial Sector

In August 1988, EC Commissioner for External Relations and External Policy, Willy de Clerq, gave a speech in which he stated, "Where international obligations do not exist, as for example in the field of services, we see no reason why the benefits of our internal liberalization should be extended unilaterally to third countries. We shall be ready and willing to negotiate reciprocal concessions with third countries..."(35)

This statement alarmed EC trading partners, who interpreted it as a sign that the EC was turning inward, and that it intended to build a kind of "Fortress Europe." The resulting publicity focused the outside world's attention not only on the reciprocity provision in the Second Banking Directive but also on the 1992 program in general.

Much of the difficulty with the reciprocity requirement stemmed from uncertainty over how the EC intended to interpret the provision. As originally framed, the provision seemed to imply that the EC could demand that outside countries treat EC banks in exactly the same way as foreign banks were treated in the EC.

This interpretation of the provision would have meant that the EC was deviating from normal international practice of requiring national treatment in foreign markets. Under national treatment, each country agrees to accord foreign firms treatment no less favourable than that given domestic firms. By contrast, in cases where the foreign jurisdiction was more liberal, mirror image reciprocity might have required that foreign firms be treated more favourably than domestic firms - a difficult public policy choice.

For financial institutions from non-member countries such as Canada, this implied that access to the EC market could be limited to that accorded EC financial institutions operating in Canada. The U.S. was most vocal in its objections to the idea of reciprocal access since it could not match the access provided by the EC. In the U.S., the <u>Glass-Steagall Act</u> prohibitions on the co-mingling of investment banking and commercial

---

(35) Willy de Clerq (1988).

banking are eroding but still remain substantially in effect. Furthermore, some restrictions remain on the establishment of bank branches across state lines. By contrast, the rules proposed for Europe 1992 would permit banks to sell services across borders or to establish branches in other countries while allowing them to sell or underwrite securities in addition to commercial lending activities.

Aside from potentially restricting the entry of new foreign institutions into the EC market, there was no assurance in the original draft of the Second Banking Directive that third-country financial institutions already existing in the EC would be permitted to continue to operate there if their home country did not comply with the reciprocity provision. Furthermore, the Directive called for an automatic suspension-and-review procedure when foreign banks undertook a corporate restructuring, made an acquisition or engaged in new activities.

In April 1989, the Commission bowed to pressure and softened the reciprocity requirement in the Second Banking Directive to mean "national treatment that gives effective market access" and dropped plans to review each new banking licence to determine the extent of access provided to EC firms in that institution's home market. Instead, the Commission will prepare periodic reports examining the treatment of EC banks in foreign markets with a view to opening negotiations with those countries that appear to be denying effective access to their financial markets. Where it is found that EC credit institutions are not being accorded genuine national treatment and effective market access, the Commission may seek to limit or suspend new authorizations for entry of foreign banks. According to the common position of the EC Council adopted on 19 June 1989, foreign institutions already established in the Community would not be subject to the automatic suspension procedure. It is hoped that this new definition of reciprocity in the Second Banking Directive will be incorporated in the directives covering the sale of securities and insurance services as well as non-financial services and procurement.

A report issued in August 1989 by a group representing EC bankers cited Canada, among other countries, as imposing tight restrictions

on the volume of foreign banking.(36) The countries identified in the report are apparently candidates for negotiation to improve access by EC banks. In Canada, foreign banks (ie. Schedule II banks) are limited to owning 12% of Canadian banking assets and must seek ministerial approval to open new branches. Under the Canada-U.S. Free Trade Agreement, U.S.-owned banks are exempt from these restrictions.

At a November 1989 conference in Toronto, the EC ambassador to Canada, Jacques Lecomte, confirmed speculation that EC banks will seek access to Canadian financial markets at least as favourable as that enjoyed by U.S. institutions. This implies exempting EC-owned banks in Canada from the 12% asset limit and the requirement to obtain ministerial approval before opening new branches. It is uncertain whether the EC will also seek exemption from restrictions limiting non-resident shareholdings in Canadian Schedule I banks and federally-chartered trust and life insurance companies.

C. Procurement

As outlined earlier, the EC intends to liberalize government procurement policies related to transport, water, telecommunications, and energy. Since these sectors are not currently included under the GATT Code on Procurement, member states would be permitted to favour tenders from European countries over those from outside the Community. The draft rules state that non-EC bids (ie., those which contain less than 50% EC content) might be excluded from contracts and in any event EC bids would receive a mandatory 3% advantage.(37)

The reciprocity provision related to procurement makes it clear that the EC is prepared to adjust its government purchasing policies favouring local suppliers in return for equivalent concessions from its trading partners. Although bilateral negotiations are possible, the issue is most likely to be resolved under the auspices of the GATT. In any case,

---

(36) "European Study Slams Canada's Banking Rules," The Financial Post, 17 August 1989, p.8.

(37) Effects of Greater Economic Integration within the European Community on the United States (1989), p.4-17.

there may be some delay while the EC first implements and digests the procurement directives on intra-EC trade before extending these to outside countries.

As currently framed, the EC procurement rules are unlikely to provide a major stimulus to exports from outside countries. Instead, they will likely encourage third-country firms to set up operations inside the EC in order to take advantage of the EC preference. This is one of the conclusions reached by a study of the implications of 1992 on the Canadian telecommunications and computer sector which states:

> To make the most of the opportunities provided by Europe 1992 Canadian telecom and computer firms will require some form of EC presence. Even small and medium sized firms will have to take on, to some degree, a multinational character if they wish to take advantage of an EC-wide market. Given the additional risks, as well as headaches, entailed by a foreign (EC) presence, many Canadian firms may not avail themselves of EC opportunities. But they cannot ignore the fact that Europe 1992 is likely to create new world-scale, European-based firms that will be in a position to challenge for a share of North American markets.(38)

Although defence procurement lies outside the jurisdiction of the EC, the 1992 program is expected to have an indirect effect on military purchasing. A study done for the Canadian government notes that many defence contractors in the EC also operate in the automotive, shipbuilding, aerospace, electronics, communications and other high technology industries which are likely to become more competitive under the single market program with a reduction of excess capacity and longer production runs.(39) This is likely, in turn, to make the European defence industries more competitive against Canadian defence contractors in Europe, North America and third countries. On the positive side, the report recognizes that many Canadian defence contractors exploit market niches and are already linked with European firms.

---

(38) Canada, External Affairs, 1992 Implications of a Single European Market, Telecommunications and Computers, Ottawa, 1989, p.9.

(39) Canada, External Affairs, Task Force on Europe 1992, Report of the Working Group on Defence Products, Supply and Services, Ottawa, 1989, p.2.

D. Technical Standards

The development of EC-wide technical and safety standards presents both risks and opportunities to foreign exporters. As indicated earlier, under the new approach to eliminating technical barriers to trade, the EC sets essential requirements for health and safety and leaves the main standards-setting bodies (CEN, CENELEC, ETSI) to hammer out the details. Where health, safety or the environment are not at risk, EC members must accept each-others' standards as legitimate.

One problem for non-member countries, such as Canada and the U.S., is that they have not been invited to participate in setting product standards. Large foreign-owned companies with European plants apparently are permitted input to the standards-setting procedure but there is concern that smaller foreign firms without a European presence will be unaware of the new standards until it is too late. The EC did state to the staff of a U.S. Congressional subcommittee that it might be willing to negotiate an agreement permitting U.S. firms to see CEN/CENELEC working papers before issuance of the draft standard.(40) However, the subcommittee report declared this would be no substitute for actual participation in the standards-setting process, and would give U.S. companies little influence over the outcome. The subcommittee report also identified as a potential problem "harmonizing up," whereby the EC could adopt the most stringent national standards in force. Thus, a foreign firm previously excluded from one national market with too stringent standards could find itself locked out of the entire EC market. In the subcommittee's view "the possibility of 'harmonizing up' reinforces the need for transparency in the standards-setting process."

Even if foreign-made products are manufactured to meet European specifications, there is no guarantee that foreign testing and certification procedures will continue to be honoured. Acceptance of foreign procedures will apparently depend on the outcome of negotiations

---

(40) United States, House of Representatives, Committee on Foreign Affairs, Subcommittee on International Economic Policy and Trade, European Community's 1992 Economic Integration Plan, U.S. Government Printing Office, Washington, D.C., 1989, p.21.

between the outside country and the EC.(41) Otherwise, it appears that foreign-made goods would have to be tested and certified by the appropriate European bodies.

Canada is particularly concerned about the outcome of a CEN committee deliberation on sizes, performance standards and testing and certification procedures for lumber. While Canada is not permitted direct input to the standards-setting process, the CEN committee does include members of the European Free Trade Association (EFTA) such as Norway, Sweden and Finland, which compete for a share of the EC lumber market. In 1988, Canada shipped $733 million worth of softwood lumber and another $88 million of hardwood lumber to the EC.

In the agri-food sector, Canadian slaughterhouses and meat processing plants will continue to be subject to inspection by the EC but will have to meet new health standards for workers coming into contact with the product as well as for plant and equipment. In order to meet the new EC standards, some Canadian firms exporting to the EC may have to make additional investment in their facilities. Similarly, Canadian food processors may have to make further expenditures in order to comply with new EC health and labelling requirements. It is uncertain whether Canadian seed potatoes now entering the Community under derogation from EC standards will be allowed to continue to do so after 1992.(42)

Despite these concerns, the EC's program to remove technical barriers to trade presents opportunities for foreign exporters. Whether it means compliance with a single standardized-EC norm or meeting one member's standard which is mutually recognized by the other member states, there will be only one set of product requirements to meet rather than twelve. Once goods are permitted entry to the EC, they will be free to circulate throughout the Community. In the case of mutually-recognized standards, an outside exporter could choose whichever member state's standard was easiest to meet but goods would have to enter the EC by way of that country.

---

(41) Ibid., p.22.

(42) Canada, External Affairs, 1992 Implications of a Single European Market, Agriculture and Food Products, Supply and Services, Ottawa, 1989.

E. Rules of Origin, Local Content and Anti-dumping Actions

Strictly speaking, changes to the EC's rules of origin and the related use of antidumping actions against foreign imports are not part of the 1992 program. Nevertheless, the Community's trading partners have noticed a definite correlation between the integration of the single market and the increasing restrictiveness of the EC's trading rules. Instead of determining the origin of goods based on the "country in which the last substantive process or operation that is economically justified is performed...,"(43) for a number of products the EC has begun defining the the country of origin in terms of their European content.

One widely publicized example is the application of "local content" rules to goods manufactured in so-called "screwdriver plants" within the EC but from foreign components. The plants, which take their name from the fact that the components are imported and merely assembled within the Community, thus adding little local value, are set up allegedly to evade antidumping duties or other restrictions on imports of the finished product. By assembling the product within the Community, the manufacturer hopes to have it considered as EC in origin and to avoid the import restrictions. In response to this perceived threat to local firms, the EC amended its trade laws to require that specific local content targets are met before the product is considered of EC origin. For example, television sets and VCRs must be composed of 45% local content to be so certified. France refused to permit entry of the Nissan Bluebird car built in Britain until the local content level was raised from 70% to 80%.(44)

The EC has also amended its trade laws to permit antidumping duties to be levied on goods assembled in the Community but 60% of whose components are imported from the exporting country that was subject to the original antidumping duty. The EC does not evaluate whether the imported components going into the finished product were also dumped but assumes that "screwdriver operations" set up after the original dumping duty are an attempt to avoid the ruling. Effectively, about 40% of the value of the

---

(43) EC Commission, Regulation 802, 1968.

(44) Canada, External Affairs, <u>1992 Implications of Single European Market Part I, Effects on Europe</u>, Supply and Services, Ottawa, 1989, p.66.

components must be EC-sourced in order to avoid the dumping duty. The products affected by this "screwdriver regulation" are made by Japanese manufacturers and include electronic typewriters, electronic weighing scales, hydraulic excavators, photocopiers and computer printers. The Japanese consider the "screwdriver regulation" unfair and have brought a complaint to the GATT over the matter. This is said to be the first time that Japan has taken such action against a trading partner since joining the body.(45)

While so far most of the EC's local content rules are aimed primarily at the Japanese, they are having spinoff effects on other countries. A case in point is the 1988 EC antidumping action against the Japanese photocopier manufacturer, Ricoh Co. Ltd. The company attempted to avoid the EC dumping ruling on Japanese copiers by importing these instead from its manufacturing plant in California. Despite the fact that the U.S. Customs Service considered them to be <u>bona fide</u> U.S.-made products, the EC Commission ruled that the copiers were still subject to dumping duties because of their Japanese parts.(46)

The EC regulation redefining the origin of semiconductors is bound to have significant effects on high-tech producers around the world. The production of semiconductors in undertaken in three main phases: the manufacture of a wafer about 6 inches in diameter; the diffusion process, where 30 to 40 semiconductor circuits are printed on the wafer; division of the wafer into individual chips. The EC regulation issued in February 1989 redefined the "last substantial process" in manufacturing semiconductors to be the second stage, the diffusion process. Previously, semiconductor manufacturers could meet the EC rule of origin by exporting the fabricated wafers and cutting them into individual chips in Europe. Thus, foreign semiconductor manufacturers will face a choice of exporting over a 14% EC tariff or setting up fabricating facilities inside the Community. Moreover, the EC's diffusion decree affects not only the rules of origin for semiconductors but also the level of Community content in products that

(45) Patrick J. McDermott, "Extending the Reach of their Antidumping Laws: The European Community's 'Screwdriver Assembly' Regulation," <u>Law and Policy in International Business</u>, Vol.20, No.2, 1988, p.323.

(46) "Getting Ready for 1992," <u>National Journal</u>, 13 May 1989, p.1182.

incorporate them. Foreign plants operating in the EC will likely prefer to purchase only semiconductors with circuits printed in the Community in order to meet the local content requirements for their finished products. This will apply to a host of products beyond those commonly thought of as purely electronic. For instance, the value of electronics in automobiles is estimated to be approaching $1,000 (U.S.) per vehicle and in 1988 $591 million (U.S.) was spent in Europe on automotive semiconductors alone.(47)

F. Broadcasting

Another element of the 1992 program which could have implications for U.S. exports is the Television without Frontiers Directive encouraging member states to ensure that "whenever practicable" a majority of broadcast programs are European. The directive is considerably diluted from earlier forms which set specific percentages for European content. As well, there is no legal obligation for countries to comply with the directive although the Commission will monitor whether the content rules are met. Nevertheless, U.S. Trade Representative Carla Hills termed it "blatantly protectionist" and indicated that the U.S. would bring the matter before the GATT.(48) It is estimated that in 1988 the U.S. sold between $1.5 billion to $2.0 billion worth of broadcasting services to the EC representing about one half of sales abroad.(49)

Until recently, it appeared that Canada too would be caught in the net of the broadcasting directive. At issue was whether Canada-France film and TV co-productions, which amounted to about $244 million in the five years to 1988, would be considered European-made for the purposes of meeting the original 50% EC content level. These initial concerns were eased with the removal of the strict content limit and agreement by French authorities, after effective lobbying by the

---

(47) Ibid., p.1183.

(48) "Television Without Frontiers," European Trends, The Economist Intelligence Unit, No.4, 1989, p.13.

(49) Effects of Greater Economic Integration within the European Community on the United States (1989), p.6-22.

Canadian government, to designate these co-productions as EC in origin. It is estimated that the value of France-Canada co-productions could exceed $125 million in 1989.(50)

CONCLUSION

With over 50% of the Commission's proposals adopted and European firms planning and making investments on the basis of a single market, the 1992 program is indeed irreversible. This should not imply that the process of integrating the internal market will be complete by 31 December 1992 but Europe will be a different place in which to do business when the deadline arrives. By that time most serious physical, fiscal and technical barriers to internal trade will have been removed and intra-EC competition should be intensive. Already, European firms are gearing up to take advantage of the new, larger market. One indication is that the number of mergers in the 1,000 largest EC firms rose from 155 in 1984 to 303 in 1987.(51)

Thus, a post-1992 Europe will present challenges to foreign firms whether operating from an EC base or attempting to export into the market. Furthermore, as EC firms expand and become more efficient, companies from outside countries will meet new competition in their home country as well as in third markets. Therefore, even Canadian firms without European aspirations may have to deal with the 1992 challenge. Fortunately, the Canada-U.S. Free Trade Agreement has given Canadian companies a head start in learning to meet global-scale competition.

In competing in the European market, foreign exporters will face other challenges besides heightened competition. They will have to contend with new technical standards that they had no part in designing, procurement practices that discriminate against non-EC bids in certain sectors and increasingly restrictive EC local content rules used in conjunction with antidumping regulations.

---

(50) "TV Regulations Will Not Affect Deals of Canadian, French Firms," Globe and Mail, 4 October 1989, p.B6.

(51) "Making Deals in Post 1992 Europe," Europe, October 1989, p.18, 20.

Despite these concerns, it is an exaggeration to say that the EC is building a "Fortress Europe." As noted earlier, it does not necessarily follow that the integration of an internal market must lead to less trade with outside countries. Furthermore, it is encouraging that the reciprocity provision in the Second Banking Directive that originally gave rise to the "Fortress Europe" accusation has been modified in a manner satisfactory to EC trading partners. In the area of procurement, 1992 does not close foreign exporters out of existing markets but it does give EC companies an advantage over outside firms in the four new sectors opened to competition. With respect to technical standards, third-country exporters will have to adjust to new requirements but then so will many EC firms. Providing standards are not written to discriminate against third-country goods, foreign exporters will continue to be able to compete.

It is perhaps ironic that the aspects of Europe 1992 that have the most protectionist potential are not really part of the program. The EC's more stringent local content requirements and use of antidumping actions in conjunction with the development of the single market are driven by a desire to ensure that the benefits of the single market accrue to European firms. After all, a major impetus behind the development of the 1992 program was the desire to meet the challenge from the EC's major competitors Japan and the U.S. The EC was concerned that large efficient outside operations should not gain greater benefit from opening up the balkanized European market than did local firms. As Mr. Delors has stated, "the external aspect of the internal market will have to be strengthened if we don't want this internal market to be of primary benefit to foreign investors."(52) In a similar vein, French President Mitterand has said, "Let us contemplate as clearly as possible the dangers which menace us. If the large market is not better protected than the present Common Market, the 'extra-Europeans' will rush to the 320 million consumers which we are and which constitute the most important melting pot in the world."(53)

---

(52) Financial Times, 27 June 1988, p.2.

(53) Le Monde, 8 April 1988.

There are, however, forces for continued trade liberalization with states such as West Germany, Britain and the Benelux countries (Belgium, the Netherlands and Luxembourg) opposing higher external import barriers. Furthermore, the EC has promised the U.S., Japan and other countries that the Community will not turn in on itself. Even Mr. Delors' statements have become more conciliatory recently, containing numerous assurances that the EC is not creating a Fortress Europe. As Mr. Lecomte has stated, "In other words, 'Fortress Europe' does not make sense. The Community's commitment to liberalization is not rhetoric, it is the simple reflection of our interests, which coincide with those of our partners."(54) The test of these recent statements will be how the EC continues to deal with issues of concern to outside countries.

(54) Jacques Lecomte, "The Single Market: A Dynamic Component of a Liberal World Economy," Speech, 25 October 1988.

SELECTED REFERENCES

Balassa, Bela. "Trade Creation and Trade Diversion in the European Common Market: An Appraisal of the Evidence." European Economic Integration. North-Holland, Amsterdam, 1975.

Brealey, Mark and Conor Quigley. Completing the Internal Market of the European Community. 1992 Handbook, Graham & Trotman, London, 1989.

Canada, External Affairs, Task Force on Europe 1992. Report of the Working Group on Defence Products, Supply and Services, Ottawa, 1989.

Canada, External Affairs. 1992 Implications of a Single European Market, Agriculture and Food Products. Supply and Services, Ottawa, 1989.

Canada, External Affairs. 1992 Implications of a Single European Market, Telecommunications and Computers. Supply and Services, Ottawa, 1989.

Canada, External Affairs. 1992 Implications of a Single Market, Part I, Effects on Europe. Supply and Services, Ottawa, 1989.

Cecchini, Paolo, et al. The European Challenge, 1992 The Benefits of a Single Market. Gower, Aldershot, U.K., 1988.

Commission of the European Communities. Assessment of the Function of the Internal Market. 24 February 1983.

Commission of the European Communities. Completing the Internal Market, White Paper to the European Council. Brussels, June 1985.

Commission of the European Communities. Community Charter of Fundamental Social Rights. Preliminary Draft. Brussels, 30 May 1989.

Commission of the European Communities. Fourth Progress Report to the Council and the European Parliament Concerning the Implementation of the Commission's White Paper on the Completion of the Internal Market. Brussels, 20 June 1989.

The Economist Intelligence Unit. European Trends, London, (various issues).

El-Agraa, Ali M. The Economics of the European Community. Second Ed. Philip Allan Publishers, Oxford, 1985.

Emerson, Michael et al. The Economics of 1992. Oxford University Press, Oxford, 1988.

Hindley, Brian. "Dumping and the Far East Trade of the European Community." The World Economy, Vol.11, No.4, December 1988.

Hine, R.C., The Political Economy of European Trade, An Introduction to the Trade Policies of the EEC. Harvester Press, Brighton, U.K., 1985.

McDermott, Patrick J. "Extending the Reach of their Antidumping Laws: The European Community's 'Screwdriver Assembly' Regulation." Law and Policy in International Business, Vol.20, No.2, 1988.

"A Survey of Europe's Internal Market." The Economist, 9 July 1988.

"A Survey of Europe's Internal Market." The Economist, 8 July 1989.

Swann, Dennis. The Economics of the Common Market. Penguin Books, Harmondsworth, England, 1984.

"Towards a Single Market: 1992." Euromoney (special supplement), 1988.

United States, House of Representatives, Committee on Foreign Affairs, Subcommittee on International Economic Policy and Trade. European Community's 1992 Economic Integration Plan. U.S. Government Printing Office, Washington, D.C., 1989.

United States, House of Representatives, Committee on Foreign Affairs, Subcommittee on International Economic Policy and Trade. European Community: Issues Raised by 1992 Integration. U.S. Government Printing Office, Washington, D.C., June 1989.

United States, U.S. International Trade Commission. Effects of Greater Economic Integration within the European Community on the United States. Washington, D.C., July 1989.